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¶1. (U) Summary. This is Volume 8, issue 18 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- Mboweni Warns on Inflation
- Prices Start to Slip as Property Boom Ends
- Government Infrastructure Spending Expected to Drive Growth

- Transnet's Big Spending Plans
- Transnet Pipeline Project
- Load-Shedding Backfires on Eskom
- Regulator Grants Extensions, but Sticks with May 23 Hearing Date for Price Increase
- SA Power, Safety Problems Reverse Six Years of Platinum Growth
- Nationwide Halts Operations
End Summary.

Mboweni Warns on Inflation

¶2. (U) South African Reserve Bank (SARB) Governor Tito Mboweni said high food and fuel costs have spilled over into second round inflationary effects that have to be tackled. He also warned in an interview with CNBC Africa that an excessive increase in electricity prices will have serious consequences for inflation. The targeted CPIX inflation gauge jumped to a five-year high of 10.1% y/y in March, raising speculation that interest rates may have to rise again. The SARB hiked its repo rate by 50 basis points to 11.5% on April 10, adding to eight half percentage point increases since June ¶2006. Mboweni said high international food and oil prices had been the spark for higher inflation, but pressures were now more widespread. "Food and oil have been the original sins, but the impact of the increases in the prices of food and oil has now spilled over into the other categories of the inflation basket, second round effects. The Reserve Bank has to try to ensure that these second round effects don't get out of control," Mboweni said. Consumer demand needed to be dampened further and inflation expectations, which rose sharply in the first quarter of 2008, had to be contained, he said. Some analysts have warned that further rate hikes could damage the economy, with consumers already battling with high prices and interest rates and a severe electricity crisis. The power shortage is widely expected to crimp growth this year, and a request from power utility Eskom for a 60% nominal tariff

increase to help fund a boost in capacity will add to pressures. Mboweni said other ways should be found to fund Eskom's capital expenditure program. Electricity tariff hikes together with wage settlements, were issues that the Monetary Policy Committee (MPC) would monitor closely, he said. The National Energy Regulator of South Africa (NERSA) will decide on the Eskom request in early June, before the next scheduled MPC meeting. However, Mboweni said the MPC did not have to wait for set meetings to make changes to its monetary stance. (Business Day, April 29, 2008 and Engineering News, April 29, 2008)

Prices Start to Slip as Property Boom Ends

¶3. (U) After years of an unprecedented property boom, South Africa's property market has begun to decline as consumers fell victim to high interest rates and soaring inflation. Standard Bank's monthly property gauge for March showed the first decline in year-on-year Qproperty gauge for March showed the first decline in year-on-year prices in almost eight years. In 2004, three years after the start of the boom, price growth reached a high of nearly 40%. ABSA Bank sees prices falling 7% this year. "We expect the industry to record lower levels of activity and prices to decline towards the end of the year," said ABSA Property Analyst Jacques du Toit. "Higher interest rates combined with the National Credit Act, with its stricter laws, have definitely had a negative impact," he said. Property market weakness is not just the result of the financial constraints on the industry, but people are increasingly gloomy and consumer confidence is at its lowest level in four years. "There is some nervousness about the political transition and crime and power utility Eskom. So if you add all those factors, people aren't very hopeful and the property industry has slowed down considerably this year as a result," du Toit said. Violent crime rates remain high, while a crippling electricity shortage is seen as threatening growth. The rise of Jacob Zuma to the presidency of the ruling ANC, with strong backing from unions and communists, has increased worries about whether the new leadership will ditch the prudent

economic policies that have spurred strong economic growth. Analysts say the property market may only start recovering when interest rates change direction. (Business Day, April 29, 2008)

Government Infrastructure Spending Expected to Drive Growth

¶4. (U) Deputy President Phumzile Mlambo-Ngcuka said the SAG's unprecedented R600 billion ($80 billion) public-investment program would continue to provide growth impetus. "South Africa is now a construction site," she quipped. The Presidency's Deputy Policy Head Alan Hirsch argued that South Africa could still attain its target of 6% growth from 2010, despite the "serious power emergency". Speaking at a media briefing following the release of the 2007 annual report for the Accelerated and Share Growth Initiative for South Africa (ASGISA), Hirsch said the power crisis was not a "fundamental impediment" to the attainment of the program's stated growth aspirations. ASGISA sought average growth rates of 4% from 2006 to 2010, to be followed by an average of 6% from 2010 to 2014. Infrastructure was also the overarching theme of the annual report itself, occupying 30 of its 70 pages. Crucially, it showed that there was a growing capacity to deliver on infrastructure projects, even at municipal levels. Investment spending by national departments rose 30% in 2006/7 and by 13% for the first two quarters of 2007/8 and there were now some 22,000 investment projects being monitored under the so-called national infrastructure project register, covering everything from bridges and municipal roads to schools and hospitals. However, Mlambo-Ngcuka stressed that creative linkages had to be found to sustain work opportunities for those currently occupied in the infrastructure projects once they were completed, and called for greater cooperation between the public and private sectors to address the challenge. Hirsch said that, in spite of the anticipation that the economy would slow down in 2008, there was no immediate reason for the government to change its target of halving poverty and unemployment by 2014. (Business Report, April 25, 2008 and Engineering News, April 24, 2008)

Transnet's Big Spending Plans

¶5. (U) Government-owned freight and logistics group Transnet announced plans to spend R80.3 billion ($10.7 billion) in the next five-years on capacity expansion. About half of the capital expenditure program will be funded from Transnet's own reserves, but R37 billion ($4.9 billion) will be borrowed. Transnet CEO Maria Ramos said Transnet's borrowing would not exceed 50% of its capital. The Freight Rail division will receive R38 billion ($5 billion), the National Port Authority will receive R16 billion ($2.1 billion), the Pipeline division will receive R11.9 billion (1.6 billion), and R9.6 billion ($1.3 billion) will be spent on Transnet Port Terminals. Plans in the rail division include modernizing Transnet's fleet by upgrading 200 locomotives and purchasing 50 new locomotives. Port expansion plans include R1 billion ($133 million) Qlocomotives. Port expansion plans include R1 billion ($133 million) to widen and deepen the entrance to Durban harbor and resurface Durban Pier One. An amount of R622 million ($83 million) is earmarked for the new Port of Ngqura and its container terminal. Ramos warned that power cuts were affecting Transnet's expansion projects. "We are from time to time affected by the power issues - like everybody else - and we are committed to deal with the savings we have been asked to work with Eskom on." (Business Times, April 24, 2008 and Engineering News April 23, 2008)

Transnet Pipeline Project

¶6. (U) Transnet CEO Maria Ramos announced that Transnet would begin construction of the urgently needed R11.2 billion ($1.5 billion) multi-product fuel pipeline from Durban to southern Johannesburg in August, and was confident of completing the project by September ¶2010. Ramos acknowledged that mitigation strategies would have to be implemented to keep South Africa 'wet', owing to the fact that growing demand was having to be increasingly supplemented by imports. The new infrastructure would also not be completed in time for the start of the FIFA 2010 World Cup and when fuel demand was expected to peak. News of a firm construction schedule for the pipeline also came amidst growing supply security fears, particularly in light of the fast-rising demand for diesel, which was not only finding its way into South Africa's growing diesel-vehicle fleet, but also into power generators. Generator units were being deployed particularly as a safeguard against

business losses associated with the prevailing power shortages. South African diesel demand totaled 9.7 billion liters in 2007, compared with 8.7 billion liters in 2006. Ramos reported that the front-end engineering design for the pipeline had been completed and the environmental approvals were expected imminently, which would open the way for the construction. Ramos stressed that Transnet Pipelines had been working with the liquid-fuel industry, as well as the Department of Minerals and Energy, on a "range of mitigating strategies" for the interim period while the pipelines were being built. One of these remedies included the introduction of drag-reducing agents to improve the efficiency of the existing pipeline network, which was already operating at full capacity. Also being interrogated were rail-based transportation solutions, including the purchase of specialized wagons to move fuel inland. (Engineering News, April 23, 2008)

Load-Shedding Backfires on Eskom

¶7. (U) Electricity experts have warned Eskom that its load-shedding strategy is back-firing, destroying electricity infrastructure and plunging communities into extended periods without power. The government has insisted that load-shedding - as the best strategy to conserve power - will continue, despite a lull over the current South African holiday period. At least two sub-stations, in Port Elizabeth and Kempton Park, exploded because of load-shedding last week. Experts warned that the ageing infrastructure of the country's sub-stations was not coping with load-shedding, and that to continue will cause worsening problems. Last week, Cape Town called on Eskom to implement different energy-saving methods, arguing that load-shedding was not yielding the desired results.

Cape Town technicians asserted that - instead of saving the required 10% on electricity usage - load shedding was having the opposite effect: where businesses and residents increased their electricity usage during those times when electricity was available, thereby adding to the pressure on the power grid and infrastructure. (The Sunday Independent, April 27, 2008)

Business Calls on Regulator to Delay Eskom Tariff Hearing

¶8. (U) Business Unity South Africa (BUSA) has written to the National Energy Regulator of SA (NERSA) calling for it to abandon its current accelerated review of state power supplier Eskom's request for a nominal 60% tariff increase to give stakeholders sufficient time to compile comprehensive responses. BUSA CEO Jerry Vilakazi called for greater transparency from the utility, as well as from government, which has come out in support for Eskom's application. "We accept that current prices are not sustainable and will have to rise," Vilakazi said, but he stressed that BUSA was strongly opposed to the quantum and timing of the proposed increase, coming on top of an approved more modest increase that began on April 1. The ANC National Working Committee agreed earlier this week that the application process should proceed, after previously Qweek that the application process should proceed, after previously calling for a halt to the public-participation process being run by NERSA on the rate increase application. A Business Day editorial recognized the difficulty in NERSA's task whose decision will inevitably be controversial and politicized. The editorial applauded the government's and the ANC's recent decision to convene an energy summit to coordinate responses to the power crisis and seek a broader consensus on the way forward. The editorial worries that efforts to tackle the crisis are already being overwhelmed by process, citing the multiple forums and task teams, of which the National Electricity Response Team is only one. (Business Day, Engineering News. April 24, 2008)

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Regulator Grants Extensions, but Sticks with May 23 Hearing Date for Price Increase

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¶9. (U) The National Energy Regulator of South Africa (NERSA) has granted the National Economic Development and Labor Council (NEDLAC) and Business Unity South Africa (BUSA) an extension until May 20 to submit written submissions on Eskom's application for a 60% nominal increase for the 2008/9 financial period. But, the April 29 deadline still held for other written submissions, as NERSA had not received any other requests for additional time. NERSA announced that the May 23 date should be retained for the actual public hearing, given that it was felt that Eskom's application should be given urgency in light of the prevailing electricity crisis. The determination of the tariff is expected on June 6. NERSA has not

discussed the implications of a call made by the ANC National Working Committee, supported by both NEDLAC and BUSA, to have a proposed national electricity summit ahead of the public hearings. Eskom CEO Jacob Maroga had welcomed the summit proposal, saying there was a definite need for a "national conversation" both on the handling of the crisis, as well as on the utility's application for a tariff increase. (Engineering News, April 25, 2008)

SA Power, Safety Problems Reverse Six Years of Platinum Growth

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¶10. (U) SA platinum production declined by over 200,000 ounces, after global mine output declined, and with little chance of a material recovery in 2008, global precious metals consultancy GFMS announced last week. GFMS said there was a great risk that this year's output might fail to match even last year's "disappointing result". Global platinum production in 2007 dropped by 6 percent, and South Africa's by 13%, from 2006 levels. GFMS said the volatile platinum price could trade between $1,700/oz and $2,400/oz this year (currently $1,961). Platinum production from South Africa - which accounts for 75 percent of global production - "stumbled badly, as six years of uninterrupted growth were thrown into reverse", according to GFMS. The decline was caused by a renewed "zero-tolerance approach" to mine site fatalities, a shortage of skilled personnel, and industrial action over wages and employee

safety. Guaranteed power to mines was stopped for five days in January, but has been restored to 90%, and 95 percent% in some cases. However, there was uncertainty over the effects of this on production levels for 2008, with expansion projects also in play. (Engineering News, April 24, 2008)

Nationwide Halts Operations

¶11. (U) Domestic airline Nationwide has shut-down service without warning as a result of soaring oil prices and the collapse of a black economic empowerment (BEE) deal under which the African General Equity Group (AGE) was expected to take over 51% of the airline. Nationwide Executive Chairman Vernon Bricknell said, "cash flow has become critical and we have decided to voluntarily cease all flight operations until further notice." Nationwide's troubles began when an engine fell off one of its Boeing-737 on take-off from Cape Town in November 2007. It was cleared of fault by a Civil Aviation Authority (CAA) audit, but Nationwide was grounded at the start of the Christmas holiday season because the CAA was dissatisfied with its record keeping on the origin of components. It was allowed to resume flying only when its aircraft had been inspected by competitor Safair. Bricknell said Nationwide's business had gradually recovered from the effects of the grounding. However, in March and April, "we faced a 30% increase in fuel costs combined with a decrease in passenger load factors". The closure of Nationwide took the Department of Transport by surprise. (Business Report, April 30, 2008)

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